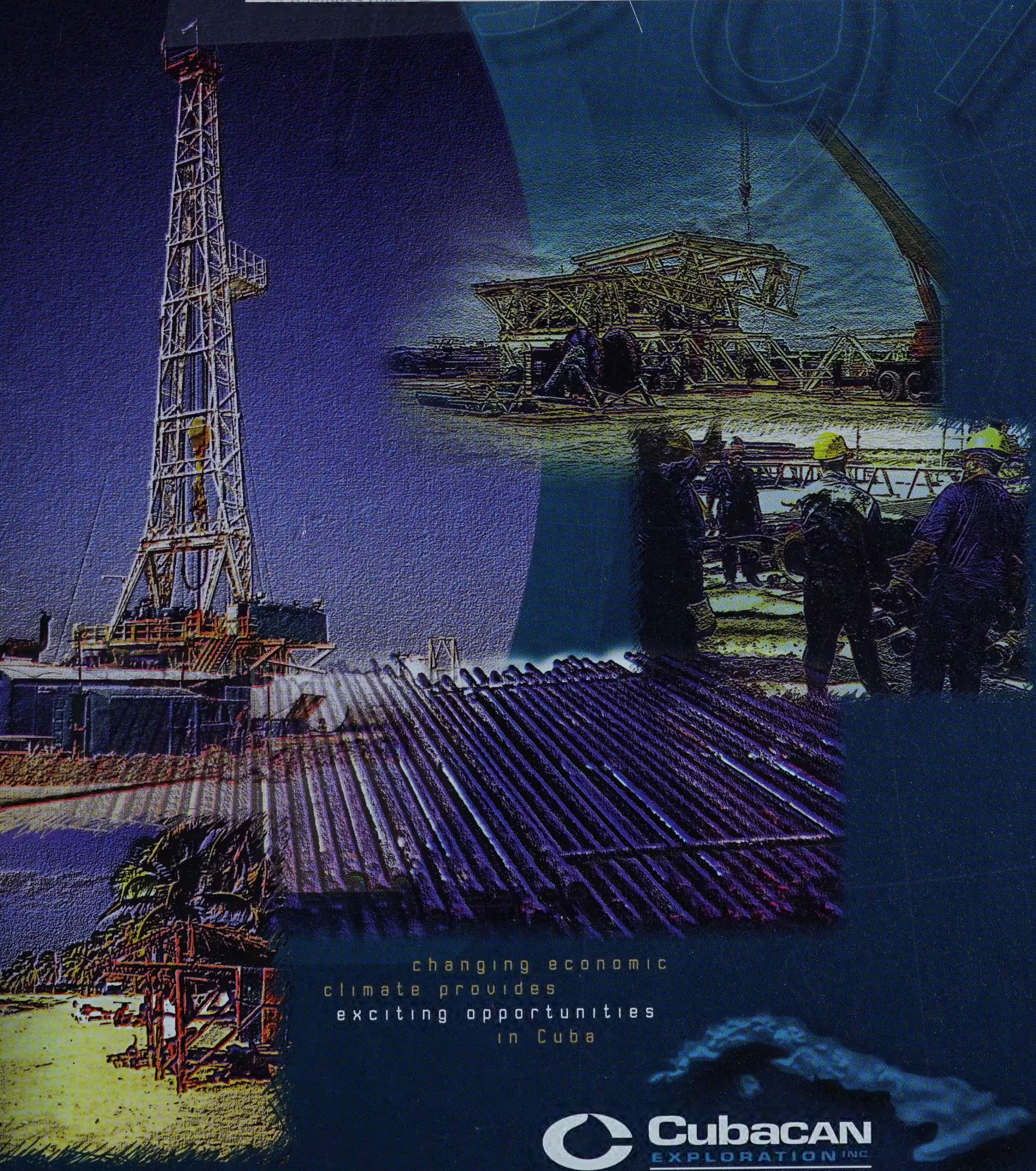
1997 annual report



changing economic
climate provides
exciting opportunities
in Cuba

Cubacan
EXPLORATION INC.

Cubacan Exploration Inc. is a Calgary based junior oil and gas exploration company with interests solely in Cuba. The Company is listed on the Alberta Stock Exchange (ASE) with shares trading under the symbol "CCX".

Annual Meeting

The Annual General and Special Shareholder Meeting will be held on Wednesday, June 24, 1998 at 3:00 p.m. in the Barber Room at The 400 Club, 710 - 4th Avenue S.W., Calgary, Alberta, T2P 0K3.

1997 Highlights

February
- $1,575,000 raised through the exercise of 3,500,000 A Warrants
- Commenced acquisition of an additional 200 km of seismic
- $4,800,000 Prospectus Offering financing completed

May
- Concluded acquisition of 200 km of additional seismic
- Block 17 Phase II seismic earning obligation completed
- Farola North #1 and La Victoria South identified as drilling targets
- Commenced environmental studies covering test locations

June
- $2,100,000 raised through the exercise of 3,500,000 B Warrants
- Acquired 25% equity interest in MacDonald Oil Exploration Ltd.
- Mr. Frank Smeenk elected to Board of Directors

August
- Entered into drilling rig contract negotiations with Oil Drilling Services of Cuba (ODS)

October
- Commenced preparation of Farola North #1 surface location

December
- Rig contract secured for Farola North #1
- Procured drilling equipment and consumables for shipment to Farola location

Contents

President's Message	1
Farola North #1	2
Other Exploration Targets	3
Petroleum Situation in Cuba	4
Auditor's Report	8
Financial Statements	9
Directors	19
Advisors to the Board	20
Corporate Information	Inside Back Cover

1997 was both a transitional and pivotal year for Cubacan Exploration Inc. Several important achievements as well as some inevitable delays characterized our progression to a true exploration Company.

Operating internationally and within a country that does not have the modern technology in place to ease this transition has, at times, been detrimental to Cubacan's efforts. Significant reforms introduced recently by the Government of Cuba indicate that the country's economic and business climate is evolving, reflecting Cuba's desire to become more self-sufficient. This is certainly encouraging and we expect that a business environment that continues to improve over the long term will significantly increase the efficiency and expediency of our operations.

Cubacan began 1997 by entering into a financing agreement with C.M. Oliver & Company Limited of Toronto, Ontario to raise $4,800,000 through a Special Warrant Financing. The financing successfully closed on February 19, 1997 with the full subscription of 8,000,000 Special Warrants through the retail and institutional markets. In June 1997, Cubacan completed its earlier financing with Jennings Capital Inc. of Calgary, Alberta, initiated in the fourth quarter of 1996, raising a total of $5,775,000.

The first quarter also saw the acquisition of an additional 200 km of seismic over specific targets on Block 17 which led to the identification of Farola North #1 and La Victoria South as drillable targets and fulfilled the Company's Phase II seismic earning obligation. To date the Company has acquired in excess of 800 km of seismic over Blocks 16 and 17 which have identified numerous exploration targets with the potential for significant hydrocarbon accumulations.

Also in the second quarter, Cubacan acquired a 25% equity interest in MacDonald Oil Exploration Ltd. ("MacDonald Oil") for investment purposes and to increase the Company's land interests in Cuba. MacDonald Oil currently operates a 100% interest in adjacent onshore Block 22, which is the largest onshore oil concession on the island at 9,900 km^2. As a result of the acquisition, Cubacan maintains an interest in over 24% of the land area of onshore oil concessions.

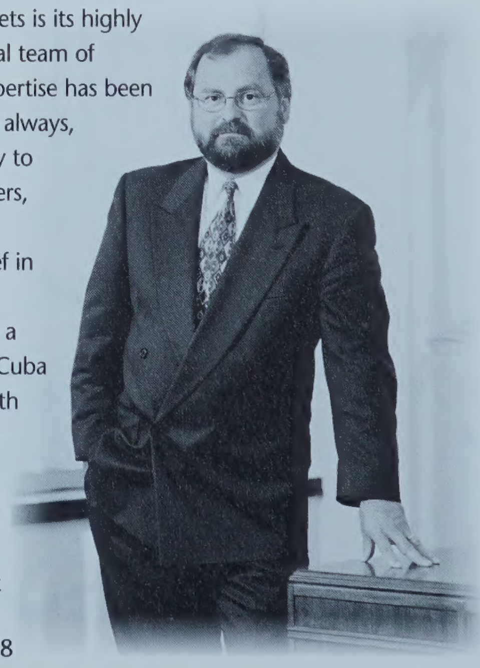
The last quarter of 1997 was spent locating and securing a rig contract with Oil Drilling Services of Cuba as well as preparing the Farola North #1 location. This entailed completing the required environmental studies and procuring drilling equipment and consumables from Canada and abroad that were subsequently shipped to Cuba and transported to the drilling location.

Drilling of the Farola North #1 well was completed in the first quarter of 1998 with hydrocarbons encountered in four zones, one of which has a gross hydrocarbon column in excess of 160 meters.

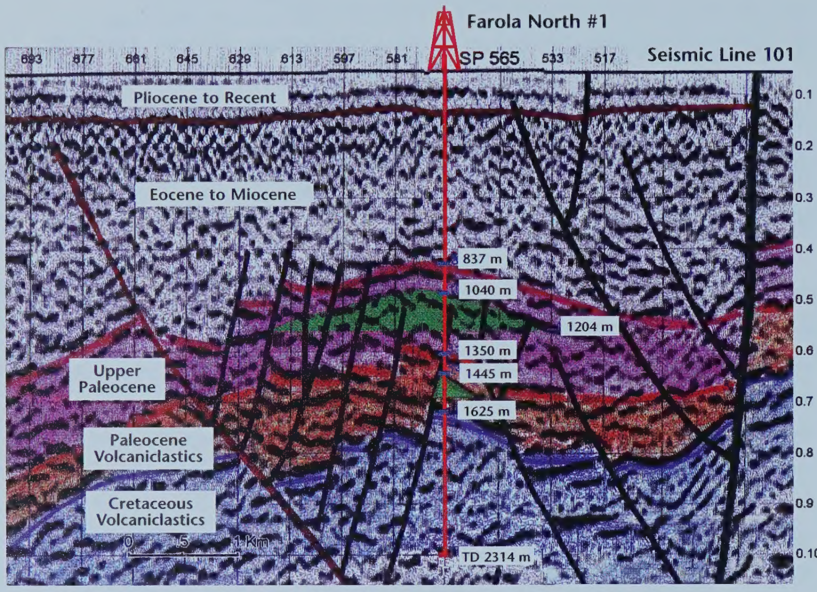
The Company is pleased to report that the substantial preliminary data collected by our technical team to date is overwhelmingly positive; in fact, the oil recovered to date is light, non-biodegraded, non-waxy, early-mature oil derived from a marine source, which are some of the best hydrocarbon characteristics discovered in Cuba to date. At the time of writing, Cubacan was in the process of sourcing a service rig or equivalent as well as additional testing equipment to test these four zones and is optimistic that the well can be brought onto production. The Company intends to implement a plan to develop this field prior to year end as well as drill additional exploration targets. The impact of the Farola North #1 well significantly reduces the Company's exploration risk of finding additional oil fields within our blocks.

Without question, Cuba has the potential for a world class discovery. Further, Cubacan is of the opinion that its blocks have the potential to be the most productive on the island. Increased exploration activity on the island, on the part of several Canadian oil and gas exploration companies, confirms that Cuba's hydrocarbon potential is now being taken seriously.

One of Cubacan's greatest assets is its highly experienced and proficient technical team of advisors and consultants whose expertise has been fundamental to our operations. As always, I would like to take this opportunity to thank our long-standing shareholders, Board of Directors and dedicated employees for their continued belief in our mission. Cubacan remains committed to its goal of becoming a significant oil and gas producer in Cuba and breaking ground at Farola North #1 signifies that we are well on our way. We certainly anticipate that 1998 will be an exciting and successful year.



Allan J. Kent
President
May 15, 1998



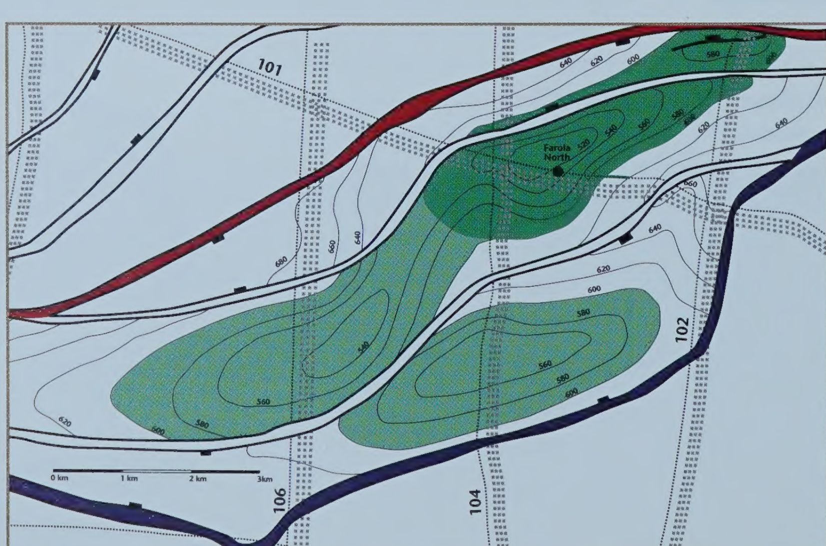
Situated onshore Block 17, Farola North #1 is the first exploration well drilled by the Company; similarly, it is the first well drilled onshore in Eastern Cuba in 40 years by a foreign oil and gas exploration company. Cubacan, which holds a 100% interest in this well, selected this location as its initial exploration target based on extensive 2-D seismic work completed in the area in addition to the presence of numerous oil seeps within seven kilometers of the drilling location.

Drilling of the well commenced February 12, 1998 and continued until March 19, 1998 to a total depth of 2,314 meters. Detrimental hole conditions forced the Company to plug back the well to 2, 085 meters at which time logging commenced. Log interpretations from an independent engineering consultant indicate four significant hydrocarbon zones have sufficient levels of porosity and hydrocarbon saturation to warrant further testing and evaluation. As a result, the well was cased to 1,600 meters.

The upper green anomaly in the corresponding seismic representation is estimated to have an area of closure between four to five square kilometers and shows a gross hydrocarbon column in excess of 160 meters.

Testing of the well immediately following logging was not completed due to damage of the testing equipment. As a result, anticipated production rates are not available at this time. Cubacan is currently in the process of obtaining a Canadian service rig or equivalent as well as additional testing equipment to production test these four hydrocarbon bearing intervals. The production testing is expected to commence in the latter part of the second quarter or early third quarter.

The oil found to date within the Farola North #1 extensional-wrench anticline is light, non-biodegraded, non-waxy, early-mature oil derived from a marine source. This oil has some of the best hydrocarbon characteristics discovered in Cuba to date.



Two-Way-Time Structure Map of the Paleocene Volcaniclastic Fractured Reservoir

Upper hydrocarbon bearing zone of the Farola North #1 well, indicated in dark green. The light green areas represent the potential expansion of the Farola North field.

The Company currently holds a 100% interest in Blocks 16 and 17 as well as a 25% equity interest in Block 22.

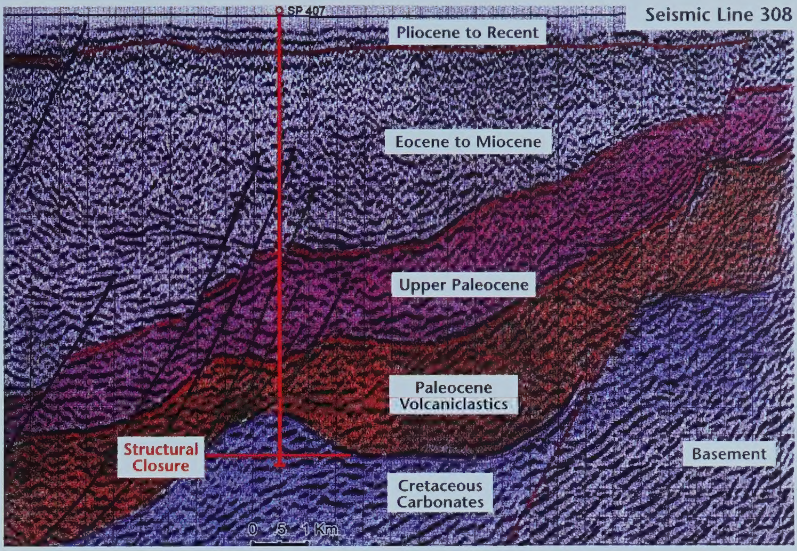
The prospectivity of the numerous leads and prospects which have been identified on our concessions has been greatly enhanced by the Farola North #1 well discovery.

These leads can be summarized into four basic play types:

- force-fold anticlines
- carbonate build-ups
- extensional wrench anticlines
- horst block structures

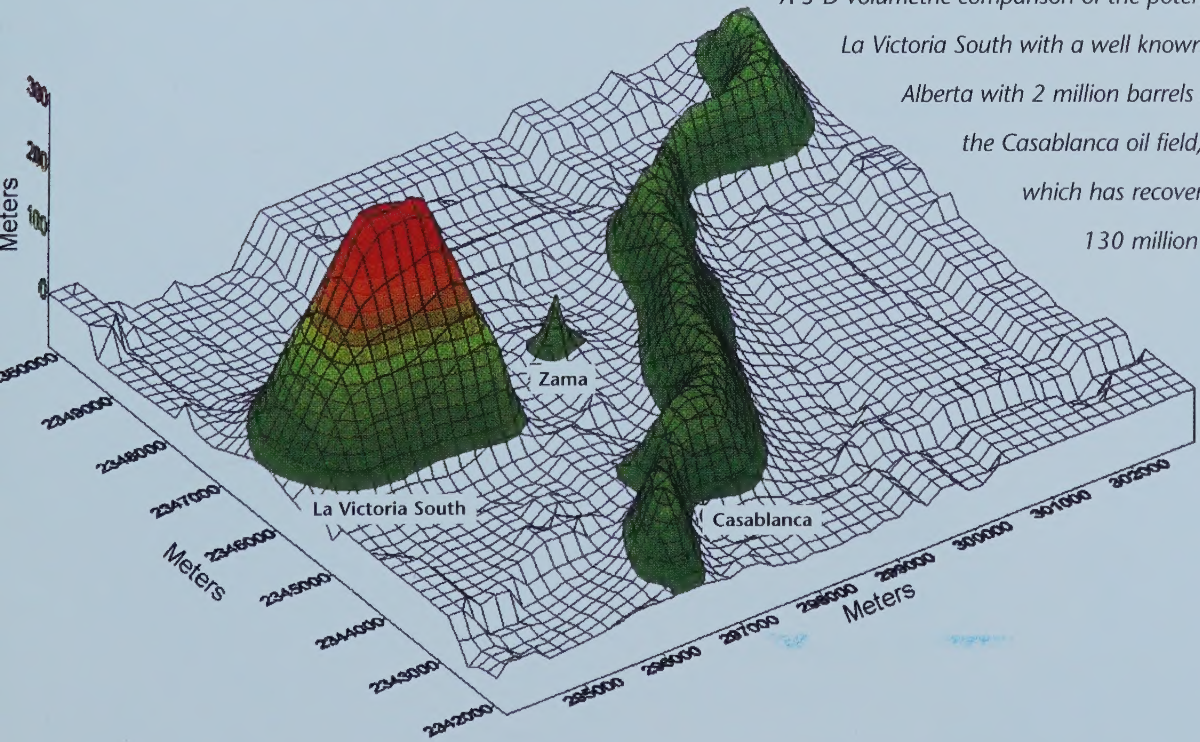
Future exploration targets scheduled for drilling consist of the Cuatro Caminos on Block 22, the Nuevitas on Block 16, and the La Victoria South situated on Block 17.

The La Victoria South prospect identified in the adjacent seismic is a carbonate reef play, located at a depth of approximately 3,600 meters. This structure has an area of closure of four square kilometers with a vertical closure in the order of 300 meters.



La Victoria South prospect

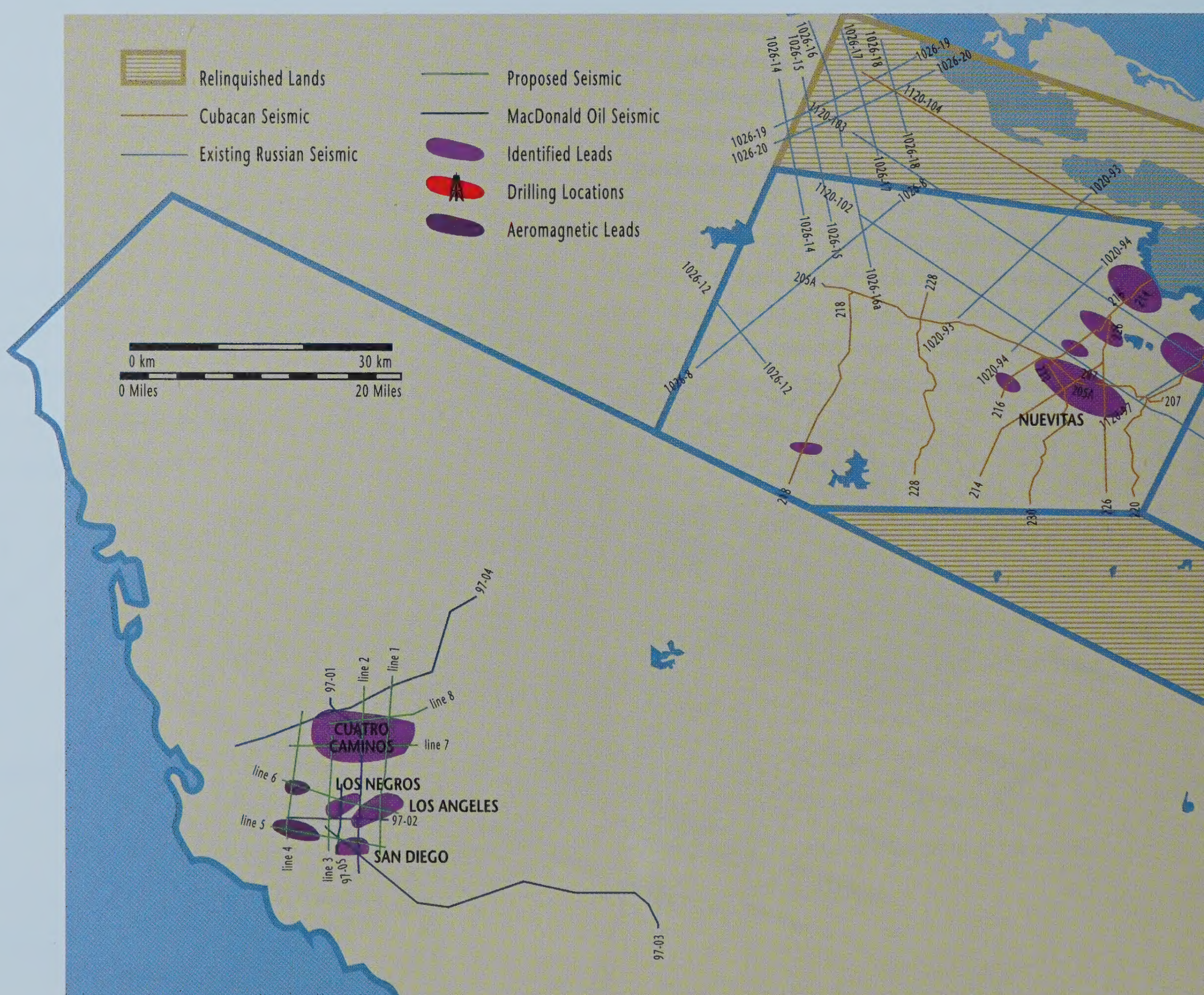
A 3-D volumetric comparison of the potential reserves of La Victoria South with a well known Zama reef in Alberta with 2 million barrels recoverable and the Casablanca oil field, offshore Spain, which has recovered in excess of 130 million barrels to date.



Cuba Oil & Gas Production

Current oil and gas production in Cuba is approximately 30,000 bopd and 32,000 mcfd respectively. Domestic oil production generates one third of the electrical power on the island and recent efforts to utilize natural gas to satisfy the excess demand for electricity have been introduced. The Varadero and Boca de Jaruco oilfields, situated in northwest Cuba, have been in production for over 25 years and comprise most of the island's current domestic oil supply. Natural gas production, on the other hand, was not used in the local economy prior to 1996 but rather flared off due to inadequate gas processing infrastructure.

At present, current demand stands at approximately 200,000 bopd. Oil imports amounting to over $1 billion annually, one third of total imports, are meant to compensate the excess demand. To date, however, Cuba has been unable to import the minimum amount of fuel necessary to operate its power generating infrastructure. Consequently Cuba suffers with chronic power shortages, and fuel continues to be the single largest drain on Cuba's foreign exchange reserves as it remains unable to export enough goods to match the significant expenditures it makes on oil imports. Both factors, in combination, continue to deter overall economic growth in Cuba.



Through the offer of attractive production sharing terms to foreign investors, the Government of Cuba is endeavouring to encourage modern hydrocarbon exploration on the island to increase its domestic oil production and thus, its self-sufficiency. Exploration that occurred prior to Cuba's sugar-for-oil barter arrangement with the Soviet Union was without the benefits of current drilling and seismic technology. Modern exploration equipment is presently scarce in Cuba, which causes foreign companies, like Cubacan, to import the vast majority of their drilling equipment needs. Continued oil and gas exploration activity on the island should help to alleviate this problem in the future.

Similarly, recent projects on the island that utilize associated natural gas for electrical power signal a recognition by the Cuban government that natural gas is a partial solution to their ongoing energy dependency problem. Domestic oil or gas discoveries by Cubacan or other international companies operating on the island would thus have a significant positive impact on Cuba's current oil import situation.

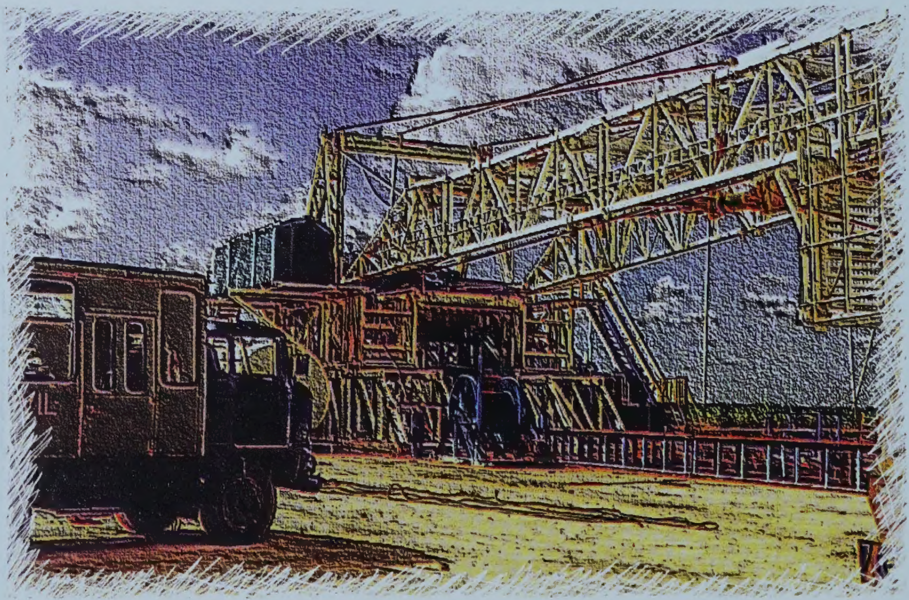
R. Charles Allen,
Executive
Vice President
and a Director
of Cubacan

Cubacan is involved in the exploration and development of a 100% interest in two Production Sharing Agreements with Cubapetroleo ("Cupet"), the Cuban national oil company, covering Blocks 16 and 17 located onshore Cuba. To date, the Company has acquired in excess of 800 km of 2-D seismic that have identified numerous exploration targets with the potential for significant hydrocarbon accumulations as shown.

Cubacan also maintains a 25% equity interest in adjacent Block 22 which is the largest onshore oil concession at 9,200 km² and is operated by MacDonald Oil Exploration Ltd.

Operated by Cupet, Cuba has four oil refineries and 11 marine terminals including the supertanker facility at Matanzas. In addition to its oil facilities, Cuba has extensive internal road, rail and air communications systems.

Gregory Harris, Barrister & Solicitor, and a Director of Cubacan



Rigging up Oil Drilling Services Rig #1 at the Farola North location.

Cuba Petroleum Geology

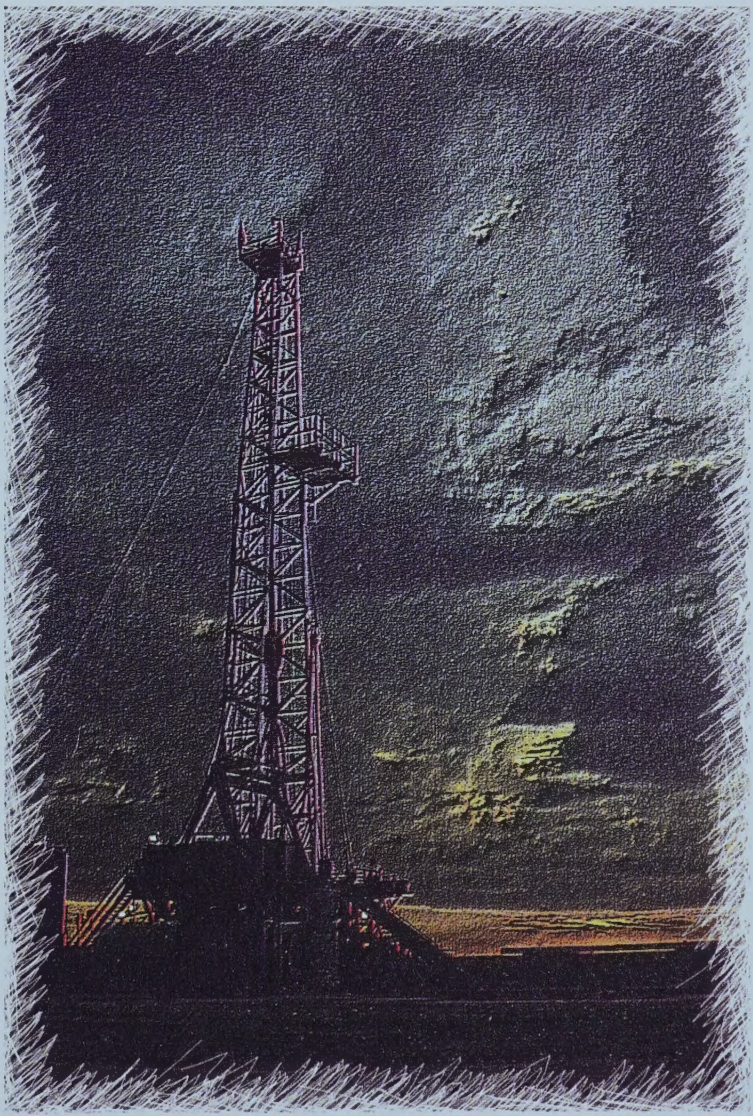
The Republic of Cuba is a drifted continental block, severed from South America with large accumulations of oil onshore with a similar origin as "Venezuelan Oil". The geological history of the island has permitted the presence of these oil pools within multiple reservoirs and trap configurations. Blocks 16 and 17 are well situated where paleo traps have had over 50 million years to accumulate extensive hydrocarbon reserves.

The hydrocarbons are reservoired in limestones, sandstones, and volcaniclastics ranging in age from Middle Cretaceous to recent. The tectonic history of the island has ensured that there are interbedded seals of claystones, salt, and calcite paleosols in conjunction with structural anticlines and carbonate buildups. Source rocks are thought to be deep water marine shales with high total organic carbon content. The history of hydrocarbon maturation and migration is variable depending on the basinal history and depth of burial.

Helms-Burton Bill

The Government of Canada's continued foreign policy of "constructive engagement" toward Cuba since the passage of The Cuban Liberty and Democratic Solidarity (LIBERTAD) Act on March 12, 1996 by U.S. President Bill Clinton has allowed Cubacan to continue its Cuban operations largely without encumbrance; however, it has notably limited the Company's financing alternatives.

Also known as Helms-Burton, the Bill authorizes private lawsuits for damages against anyone who "traffics" in property confiscated, without compensation, by the Government of Cuba from persons who at the time were, or have since become, U.S. nationals. Previous due diligence performed by the Company has verified that Cubacan is not dealing with expropriated property. In addition, assets covered by our Production Sharing Agreements do not include prior producing reserves or surface infrastructure which further absolves Cubacan of dealing with expropriated property.



Farola North #1 location,
Oil Drilling Services Rig #1

Auditors' Report

To the Shareholders of
Cubacan Exploration Inc.

We have audited the consolidated balance sheets of Cubacan Exploration Inc. as at December 31, 1997 and December 31, 1996 and the consolidated statements of earnings and retained earnings and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1997 and 1996 and the results of its operations and changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

Doane Raymond.

Chartered Accountants
Canadian Member Firm of Grant Thornton International

Calgary, Alberta
March 6, 1998

Consolidated Balance Sheet

December 31	1997	1996
Assets		
Current		
Cash and term deposits (Note 3)	$ 1,509,128	$ 706,064
Receivables	78,620	411,913
Note receivable (Note 4)	375,000	—
Due from related companies (Note 10)	17,450	—
Investment (Note 5)	600,000	—
	2,580,198	1,117,977
Petroleum and natural gas properties (Note 6)		
Prepaid drilling costs	2,040,492	—
Property and equipment	10,616,264	8,345,131
	12,656,756	8,345,131
	$ 15,236,954	$ 9,463,108
Liabilities		
Current		
Payables and accruals	$ 835,946	$ 1,829,342
Notes payable	303,924	—
Due to related companies (Note 10)	653,454	2,916,624
Current portion of long-term debt	—	180,000
	1,793,324	4,925,966
Long-term debt (Note 7)	—	155,000
Cash call deposit	—	400,572
Preferred shares	—	250,000
	1,793,324	5,731,538
Shareholders' Equity		
Capital stock (Note 8)	12,894,419	3,688,560
Retained earnings	549,211	43,010
	13,443,630	3,731,570
	$ 15,236,954	$ 9,463,108

Commitments (Note 12)

On behalf of the Board

Director ______________________ Director ______________________

See accompanying notes to the financial statements.

Consolidated Statements of Earnings and Retained Earnings

Year Ended December 31		1997		1996
Revenue				
Petroleum and natural gas sales	$	—	$	256,115
Royalties		—		(21,765)
		—		234,350
Expenses				
Operating		—		80,067
General and administrative		—		47,023
Interest on long-term debt		—		29,432
Depletion and depreciation		—		138,118
		—		294,640
Net loss from operations		—		(60,290)
Other				
Gain on sale of subsidiary		501,366		—
Gain on sale of Canadian property and equipment		—		171,315
Miscellaneous		4,835		75
		506,201		171,390
Net earnings	$	506,201	$	111,100
Retained earnings (deficit), beginning of year	$	43,010	$	(68,090)
Net earnings		506,201		111,100
Retained earnings, end of year	$	549,211	$	43,010
Earnings per share				
Basic	$	0.02	$	0.01

See accompanying notes to the financial statements.

Consolidated Statement of Changes in Financial Position

Year Ended December 31	1997	1996
Cash derived from (applied to)		
Operating		
Net earnings	$ 506,201	$ 111,100
Depletion and depreciation	—	138,118
Gain on sale of subsidiary	(501,366)	—
Gain on sale of Canadian property and equipment	—	(171,315)
	4,835	77,903
Change in non-cash operating working capital (Note 11)	(3,011,799)	1,400,126
	(3,006,964)	1,478,029
Financing		
New long-term debt	—	190,000
Long-term debt repayments	(335,000)	(175,000)
Issue of common shares for cash, net of issuance costs	8,355,859	2,515,476
Issue of common shares on conversion of preferred shares	250,000	—
Conversion of preferred shares	(250,000)	—
Issue of common shares for acquisition of investment	600,000	—
Issue of common shares for acquisition of subsidiary	—	757,944
	8,620,859	3,288,420
Investing		
Purchase of Canadian property and equipment	—	(16,671)
Prepaid drilling costs	(2,040,492)	—
Purchase of International property and equipment	(2,271,133)	(4,627,969)
Sale of Canadian property and equipment	—	850,000
Acquisition of subsidiary	—	(689,545)
Proceeds on sale of subsidiary	501,366	—
Acquisition of investment	(600,000)	—
Cash call deposit	(400,572)	400,572
	(4,810,831)	(4,083,613)
Net increase in cash	803,064	682,836
Cash and term deposits, beginning of year	706,064	23,228
Cash and term deposits, end of year	$ 1,509,128	$ 706,064

See accompanying notes to the financial statements.

Notes to the Consolidated Financial Statements
December 31, 1997

1. Nature of operations

The Company is actively engaged in the pursuit of petroleum and natural gas through exploration and development in the Republic of Cuba. The Company is considered to be in the pre-production stage and all direct costs, net of incidental revenue have been capitalized.

2. Summary of significant accounting policies

These financial statements have been prepared in accordance with generally accepted accounting principles, and reflect the following policies:

a) Petroleum and natural gas properties

The Company follows the full cost method of accounting for its petroleum and natural gas operations. All costs of exploring for and developing oil and gas reserves are capitalized, including land acquisition costs, geological and geophysical costs, carrying charges on non-producing properties, costs of drilling both productive and non-productive wells, production equipment costs, related overhead costs and capitalized interest related to unproven properties and major development projects. Such costs, net of proceeds from minor disposal of property, are accumulated, depleted and depreciated on a country-by-country basis by using the unit-of-production method based on estimated gross proved reserves of oil and natural gas. Oil and natural gas production and reserves are converted into equivalent units based upon estimated relative energy content.

Costs of acquiring and evaluating unproved properties and major development projects are excluded from depletion and depreciation calculations until it is determined whether or not proved reserves are attributable to the properties, the major development projects are completed, or impairment occurs.

The capitalized costs less accumulated depletion, depreciation and deferred taxes are limited to an amount equal to the estimated net revenue from proved reserves (based on prices and costs at the balance sheet date) less estimated future general and administrative expenses, financing costs and taxes.

Gains or losses are recognized upon the sale or disposition of properties if either proved reserves of those properties are significant in relation to the Company's total reserves or the sale or disposition is that of a major development project.

b) Future site restoration and abandonment costs

Estimated future costs relating to site restoration and abandonments are provided for over the life of proved reserves on a unit-of-production basis. Costs are estimated, net of expected recoveries, based upon current legislation, costs, technology and industry standards. The annual provision is recorded as additional depletion and depreciation. The accumulated provision is reflected as a non-current liability and actual expenditures are charged against the accumulated provision when incurred.

2. Summary of significant accounting policies (continued)

c) Joint operations

Certain of the petroleum and natural gas activities are conducted jointly with others. These financial statements reflect only the Company's proportionate interest in such activities.

d) Earnings per share

Earnings per common share are calculated based upon the weighted average number of common shares outstanding during the year. Fully diluted per share figures are not provided where the exercise of options and warrants is non-dilutive.

e) Principles of consolidation

The consolidated financial statements include the accounts of Solstice Resources International Inc., a private wholly-owned subsidiary, incorporated under the Companies Act of Barbados 1992, after the elimination of inter-company transactions and balances.

f) Financial instruments

The Company has estimated the fair value of its financial instruments which include accounts receivable, due to and from related companies, notes receivable and payable, accounts payable and cash call deposits. The Company has used valuation methodologies and market information available as at year end and has determined that the carrying amounts of such financial instruments approximate fair value in all cases.

g) Measurement uncertainty and the use of estimates

The preparation of the financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates are subject to measurement uncertainty. Actual results could differ from and affect the results reported in these financial statements.

3. Cash and term deposits

The Company provided an assignment of a term deposit totalling $840,000 as security on an irrevocable letter of credit payable to Cubapetroleo (Note 12). Subsequent to the year end, the security requirement was modified to allow the use of the restricted cash for payment of drilling accounts in Cuba.

	1997	1996
Restricted term deposit	$ 840,000	$ —
Unrestricted cash	669,128	706,064
	$ 1,509,128	$ 706,064

4. Note receivable

The note receivable is due December 31, 1997, bears interest at 7%, and is secured by 2,000,000 common shares of MacDonald Oil Exploration Ltd. As at the audit report date, the Company is negotiating the recovery of this amount.

Management is of the opinion that the amount is fully recoverable and accordingly, the security has not as yet been called upon.

5. Investment

During the year, the Company entered into an agreement to acquire 4,000,000 common shares (approximately 25%) of MacDonald Oil Exploration Ltd. in exchange for 1,000,000 common shares of the Company (Note 10). In the opinion of management, this transaction has been completed except for the delivery of the MacDonald Oil Exploration Ltd. common shares.

This investment is carried on a cost basis, which management believes represents fair market value, and is presented as a current asset.

6. Petroleum and natural gas properties

			1997	1996
	Cost	Accumulated Depreciation	**Net Book Value**	Net Book Value
Prepaid drilling costs	$ 2,040,492	$ —	**$ 2,040,492**	$ —
Property and equipment	10,616,264	—	**10,616,264**	8,345,131
	$ 12,656,756	$ —	**$ 12,656,756**	$ 8,345,131

The prepaid drilling costs of $2,040,492 (1996 - nil) consists of drilling supplies and supply inventory for the drilling of the Farola North #1 well which commenced, subsequent to the year end, on February 12, 1998.

The Company is still in the pre-production stage of exploration and development and as a result no depletion or depreciation has been recorded to date. Given the stage of development, no ceiling test has been applied.

During the year the Company capitalized overhead of $450,113 and interest and financing expenditures of $43,804, relating to the exploration activities in the Republic of Cuba (1996 - $287,370 and $88,089 respectively).

7. Long-term debt

	1997	1996
Bank loan, bearing interest at prime plus 1%, repayable in monthly principal payments of $15,000 and secured by a general security agreement	**$ —**	$ 335,000
Less: current portion	**—**	(180,000)
	$ —	$ 155,000

8. Capital stock

a) Authorized

Unlimited number of common shares

Unlimited number of preferred shares with no nominal or par value

b) Issued common shares

	1997		1996	
	Number of Shares	**Stated Value**	Number of Shares	Stated Value
Balance, beginning of year	**20,919,551**	**$ 3,688,560**	2,802,500	$ 415,140
Transactions during the year:				
Private placement	**—**	**—**	1,724,200	517,260
Issued by way of public offering, net of issue costs	**—**	**—**	7,000,000	1,760,466
Issued on exercise of options	**788,750**	**164,394**	326,250	65,250
Issued on exercise of warrants	**7,635,000**	**3,862,500**	665,000	172,500
Issued on exercise of special warrants, net of issue costs	**8,000,000**	**4,328,965**	—	—
Issued on conversion of preferred shares	**750,000**	**250,000**	—	—
Issued for purchase of investment (Note 5)	**1,000,000**	**600,000**	—	—
Issued on business combination	**—**	**—**	8,401,601	757,944
Balance, end of year	**39,093,301**	**$12,894,419**	20,919,551	$3,688,560

c) Issued preferred shares

	1997		1996	
	Number of Shares	**Stated Value**	Number of Shares	Stated Value
Balance, beginning of year	**250,000**	**$ 250,000**	250,000	$ 250,000
Transaction during the year:				
Conversion of preferred shares	**(250,000)**	**(250,000)**	—	—
Balance, end of year	**—**	**$ —**	250,000	$ 250,000

During the year, the 250,000 redeemable, retractable, convertible preferred shares with a stated value of $1.00 per share were converted into 750,000 common shares of the Company at $0.33 1/3 per common share.

d) Special warrants

During the year, the Company issued 8,000,000 special warrants at a price of $0.60 per special warrant for total cash consideration of $4,800,000 less issuance costs. Each special warrant was deemed to be exercised on June 19, 1997 with no further compensation being paid.

e) Warrants

At December 31, 1997, warrants for 4,800,000 common shares were outstanding with exercise prices of $0.60 (800,000) and $0.75 (4,000,000) and an expiration date of February 19, 1998. Subsequent to December 31, 1997, these warrants expired.

f) Stock options

During the year, stock options for 788,750 common shares were exercised at varying prices for a total cash consideration of $164,394.

At December 31, 1997, there are outstanding stock options for directors, senior officers and key personnel of 1,137,500 common shares at exercise prices of $0.20 (137,500) and $0.60 (1,000,000) expiring on January 18, 2000 and January 31, 1998 respectively. Subsequent to December 31, 1997, the January 31, 1998 options expired.

At December 31, 1997 there are other outstanding stock options for 50,000 common shares at an exercise price of $1.07 expiring March 5, 1998. Subsequent to December 31, 1997, these options expired.

Subsequent to December 31, 1997, on March 2, 1998, stock options for directors, senior officers, and key personnel of 3,000,000 common shares at an exercise price of $0.45 were issued for a period of one year.

9. Income taxes

The provision for income taxes differs from the results which would be obtained by applying the combined Federal and Provincial tax rate of approximately 44% (1996 - 44%) to the earnings before income taxes. This difference results from the following items:

	1997	1996
Expected income tax expense	**$ 222,728**	$ 48,884
Non-taxable portion of capital gain	**(55,150)**	—
Share issue costs deducted	**(71,405)**	(6,192)
Non-deductible crown charges	—	9,219
Recognition of previously unrecognized deferred tax debit	**(96,919)**	—
Resource allowance	—	(11,286)
Alberta Royalty Tax credits	—	(6,318)
Other	**746**	(34,307)
Provision for income taxes	**$ —**	$ —

The Company has available the following approximate amounts which may be deducted, at the annual rates indicated, in determining taxable income of future years.

	Rate	**1997**	1996
Canadian resource expenses	10% - 100%	**$ 11,000**	$ 11,500
Share issue costs deductible	20%	**$ 567,000**	$ 258,000
Foreign exploration and development expense (deductible at greater of 10% or Foreign resource profits)		**$8,528,000**	$4,434,000

The Company has $21,500 of available loss carry forwards for income tax purposes which have not been reflected in these financial statements. These losses expire in 2002 and 2003.

10. Related party transactions

a) **Prospect Oil & Gas Management Ltd.**

The Company is related by common management and a director who controls Prospect Oil & Gas Management Ltd. The Company has contracted for general and administrative services by way of a 12 month renewable contract. The contract provides for monthly fees of $15,000 CDN and $7,500 US for a Cuba coordinator; fees for the year ended December 31, 1997 totalled $304,485 (1996 - $226,907). Charges for other services provided and reimbursable costs during the year ended December 31, 1997 totalled $110,262 (1996 - $33,848). These transactions were made at normal market prices, terms and conditions.

At December 31, 1997, the Company owed Prospect Oil & Gas Management Ltd. $383,271 (1996 - $625,532) as a result of services rendered and cash advances which bear no interest and have no set terms of repayment.

b) **Endeavour Resources Inc.**

The Company is related by common management. Endeavour Resources Inc. is a shareholder of the Company and at December 31, 1997 owned 11.3% of the outstanding shares.

At December 31, 1997, the Company owed Endeavour Resources Inc. $270,183 (1996 - $2,118,600) as a result of cash advances which bear no interest and have no set terms of repayment.

c) **MacDonald Oil Exploration Ltd.**

The Company is related by virtue of a 25% investment in MacDonald Oil Exploration Ltd. The president of MacDonald Oil Exploration Ltd. is a director of the Company.

During the year, the Company acquired 4 million common shares of MacDonald Oil Exploration Ltd. (approximately 25%) in exchange for 1 million common shares of the Company. The investment was recorded based on the market value of the shares issued ($600,000). The acquisition was made for investment purposes.

At December 31, 1997, MacDonald Oil Exploration Ltd. owed the Company $17,450 (1996 - nil).

11. Change in non-cash operating working capital

	1997	1996
Receivables	$ 333,293	$ (392,225)
Note receivable	(375,000)	—
Due from related companies	(17,450)	102,456
Payables and accruals	(993,396)	1,800,888
Notes payable	303,924	—
Due to related companies	(2,263,170)	2,916,624
	(3,011,799)	4,427,743
Working capital deficiency, net	—	(3,027,617)
	$ (3,011,799)	$ 1,400,126

12. Commitments

The Production Sharing Agreements with Cubapetroleo, the Cuban national oil company, require various work commitments to be completed by the Company in order to remain in good standing. These commitments are to be carried out in 3 phases over a specific time period. The following commitments were outstanding at December 31, 1997.

Block 16

(a) Phase II (to be completed by August 31, 1998)
- Acquire, process and interpret 200 kilometers of seismic data
- Drill one exploratory well

(b) Phase III (to be completed by August 31, 1999)
- Drill two exploratory wells

Block 17

(a) Phase II (to be completed by April 10, 1998)
- Drill one exploratory well

(b) Phase III (to be completed by April 10, 1999)
- Drill two exploratory wells

The Company posted, by way of a letter of credit, a $600,000 US ($840,000 CDN) deposit to Cubapetroleo which is returnable upon the completion of the Phase II work commitment. Subsequent to the year end this amount was paid to cover drilling accounts in Cuba (Note 3).

Allan J. Kent

Mr. Kent, B.Math., of Calgary, Alberta is a founder and President of Cubacan. He is also a director of MacDonald Oil Exploration Ltd., as well as the Chief Financial Officer and a director of Endeavour Resources Inc., an ASE listed junior oil and gas company. Mr. Kent is the President, a director and co-owner of Prospect Oil & Gas Management Ltd., a private Alberta junior oil and gas company. Prior thereto, beginning in 1980, he was a consultant in various capacities to a number of companies in the oil and gas industry. He received his Bachelor of Mathematics degree in 1977 from the University of Waterloo.

R. Charles Allen

Mr. Allen, B.Ed., LL.B., of Calgary, Alberta is Executive Vice President of Cubacan. He is also a director of Endeavour Resources Inc. Prior thereto, he was at various times the Chairman, a director and Corporate Secretary of Fibre-Klad Industries Ltd., predecessor to Tanqueray Resources Ltd., an ASE listed junior mining exploration company from 1989 to 1994. From 1989 to 1991, he was Corporate Counsel for the Business Development Group of Amoco Canada Petroleum Company Ltd. Mr. Allen graduated from the University of Alberta with an LL.B. in 1983 and B.Ed. in 1977.

Frank C. Smeenk

Mr. Smeenk, B.A., LL.B., of Kleinburg, Ontario is the Chairman of both MacDonald Oil Exploration Ltd. and MacDonald Mines Exploration Ltd. Both companies have been engaged in exploration exclusively in Cuba since 1994. Prior to 1994, he was executive director of Deak Resources Corporation and, from 1988 to 1989, served as President. From 1976 to 1987 he practiced law and was a managing partner with Mackewn, Smeenk, Winder, Leach of London, Ontario. He is presently a director of several public companies including NFX Gold Inc., Northfield Capital Corp. and Northfield Minerals Inc. Mr. Smeenk obtained his B.A. and LL.B. at the University of Western Ontario in 1971 and 1974 respectively.

From left to right, Frank C. Smeenk, Richard J. Wojcik and John B. Kehl

Richard J. Wojcik

Mr. Wojcik, of Shelbourne, Ontario has been Vice President, Engineering of Premier Pipelines Inc., a Mississauga, Ontario private engineering and construction company from 1989 to the present with responsibilities in Canada and overseas pipeline construction.

John B. Kehl

Mr. Kehl, C.A., of Brampton, Ontario has been Vice President and Chief Financial Officer of ABC Group Inc., a private Canadian company and worldwide manufacturer of plastic automotive systems from 1987 to present. Prior thereto, he held senior financial positions in various private and public companies. Mr. Kehl received his C.A. designation in 1976 and graduated from the University of Waterloo with a Bachelor of Mathematics degree in 1974.

Gregory R. Harris

Mr. Harris, B.A., LL.B., of Calgary, Alberta is a Barrister and Solicitor in private practice since 1990 and with various law firms since 1972. Mr. Harris is a director and officer of Canadian Shield Resources Inc., a junior capital pool company; corporate secretary of both Alpha Ventures Inc., a publishing and media company, and Process Capital Corp., a waste oil refining company, all of which are ASE listed. He was a founding shareholder and director of Northrock Resources Ltd., Brittany Energy Inc., Brigadier Energy Inc., Rangeland Resources Ltd., Lorrac Energy Ltd., all publicly traded oil & gas companies. He graduated from the University of Alberta with a B.A. in 1970 and an LL.B. in 1971.

Robert A. McPherson

Dr. McPherson, Ph.D., P.Eng., P.Geol., of Calgary, Alberta earned his Ph.D. in Geology from the University of Manitoba in 1970 and has been actively involved in the oil and gas industry since that time. Dr. McPherson worked for Shell Canada in both Canada and the United States prior to joining Geoffrion, Robert, Gelinas Ltd. as an oil analyst. In 1978, he moved to Calgary and became involved in the exploration and development of both domestic and foreign oil and gas properties. He is currently the President of Hampton Court Resource Corp., an ASE listed resource company, and is director of several public companies that are active in the international oil and gas and mining industries.

Our Advisors from left to right: Robert A. McPherson, Jean P. Roy, Conrad P. Kathol and Francis P. Elliott

Jean P. Roy

Mr. Jean P. Roy, B.Sc.Geol., P.Geoph., of Calgary, Alberta is President of GeoGlobal Technologies Inc., a geotechnical consulting firm, which he formed in 1995. Mr. Roy has extensive geological and geophysical experience in basins worldwide as he has worked on projects throughout North and South America, Europe, and the Middle East, the former Soviet Union and South East Asia. His specialties include modern seismic data acquisition and processing techniques, and integrated geological and geophysical data interpretation. Since 1981 he has held geophysical positions with Petro Canada, GEDCO, Eurocan U.S.A., British Petroleum and others. Mr. Roy graduated from St. Mary's University in Halifax in 1982 with a B.Sc. in Geology. He has been certified as a Professional Geophysicist and is a member of A.P.E.G.G.A.

Conrad P. Kathol

Mr. Kathol, B.Sc., P.Eng., of Calgary, Alberta is an engineering graduate of the University of Alberta and has worked in the oil and gas industry for the past 27 years. Mr. Kathol has worked as an exploration geologist, generating prospects throughout Western Canada and has a strong background in all aspects of the industry including modern exploration technology, reservoir engineering and economic evaluation. During the past 10 years, Mr. Kathol has held the position of Vice President of Exploration for two successful Canadian companies, Elan Energy Inc. and most recently Strike Energy Inc. Mr. Kathol is the President of Invader Exploration Inc., an ASE listed junior oil and gas company, and is a director of several public companies that are active in the international oil and gas industry.

Francis P. Elliott

Mr. Elliott, B.Sc.Geol., of Calgary, Alberta is Chief Executive Officer of Jerez Energy International Inc. and President of Peregrine Oil and Gas Ltd., both ASE listed oil and gas companies. Currently a director of Cubacan, Mr. Elliott will assume an advisory role as of the Annual General Meeting. From 1991 to the present, he has been a consultant to Abacan Resources Corporation, a TSE listed and NASDAQ quoted oil and gas exploration company with interests in Nigeria. From 1989 to 1991, he was Vice President of Robson Petroleum Limited and from 1981 to 1988, he was President of Dune Resources Ltd., a TSE listed and NASDAQ quoted public oil and gas company. Prior thereto, beginning in 1968, he was employed as a geologist in the oil and gas industry. Mr. Elliott is a Professional Geologist and obtained his B.Sc.Geol. in 1976 from the University of Calgary.

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Executive V.P., Cubacan Exploration Inc.

Frank C. Smeenk, B.A., LL.B.
President, MacDonald Oil Exploration Ltd.

John B. Kehl, C.A.*
Vice President & C.F.O., ABC Group Inc.

Francis P. Elliott, B.Sc.Geol.*
C.E.O., Jerez Energy International Inc.

Gregory R. Harris, B.A., LL.B.
Barrister and Solicitor

Richard J. Wojcik
V.P. Engineering, Premier Pipelines Inc.

*denotes member of audit committee

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Robert A. McPherson, Ph.D., P.Eng., P.Geol.
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Conrad P. Kathol, B.Sc., P.Eng.
President, Invader Exploration Inc.

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